

BEFORE THE
 PUBLIC SERVICE COMMISSION OF WISCONSIN

In the Matter of the Application for All)	
Approvals Necessary for the Transfer of an)	Docket No. _____
Undivided Ownership Interest in the Presque)	
Isle Power Plant from Wisconsin Electric)	
Power Company (d/b/a We Energies) to)	
Wolverine Power Supply Cooperative, Inc.)	

APPLICATION

Wisconsin Electric Power Company ("Wisconsin Electric") hereby requests that the Public Service Commission of Wisconsin approve a transaction by means of which Wisconsin Electric will transfer to Wolverine Power Supply Cooperative, Inc. ("Wolverine") an undivided ownership interest in the Presque Isle Power Plant ("PIPP"). Wolverine, a cooperative headquartered in Cadillac, Michigan, is owned by and supplies wholesale electric power to seven members. PIPP, which is located in Marquette, Michigan, is currently owned in its entirety by Wisconsin Electric. In return for receiving roughly a one-third ownership interest in PIPP, Wolverine will provide all of the financial capital necessary to undertake an air quality control system ("AQCS") project at PIPP costing between \$130 and \$140 million that will ensure the facility's compliance with applicable federal environmental laws and regulations.

The proposed transaction is in the best interest of Wisconsin Electric's retail electric customers because it delivers significant savings to those customers by accomplishing the required AQCS project at zero capital cost to them. The Company will also retain sufficient capacity after the sale of capacity to Wolverine to meet MISO and PSCW capacity reserve margin expectations. In addition, by reducing Wisconsin Electric's ownership interest in PIPP by roughly one-third, the transaction reduces by several million dollars annually the operating and maintenance costs paid by those customers, as well as reducing their share of any future capital costs at PIPP.

Commission approval of the transaction is sought under §196.80, Wis. Stat. Because the AQCS will be constructed at a facility located in another state and because the proposed transaction results in none of the project cost being allocated to Wisconsin for rate making purposes, Wisconsin Electric does not believe that a certificate of authority is required. However, to support this application under §196.80, which requires finding that the transaction is consistent with the public interest, Wisconsin Electric is providing as an appendix the same sort of information and analysis it would provide to support a request for a CA under §196.49. If the Commission concludes that a CA is in fact required, Wisconsin Electric asks that this application be treated as a request for a CA under §196.49, as well as for approval of the proposed transaction under §196.80.

I. Summary of the proposed transaction.

Wisconsin Electric is currently the sole owner of PIPP, a facility that consists at this time of five coal-fired, base-load units with the following characteristics:

	<u>Year in service</u>	<u>Net generating capacity</u>
Unit 5	1974	80 MW with bituminous coal 55 MW with subbituminous coal

Unit 6	1975	80 MW with bituminous coal 55 MW with subbituminous coal
Unit 7	1978	78-85 MW
Unit 8	1978	78-85 MW
Unit 9	1979	78-85 MW

PIPP Units 1 and 2 were retired from operation on January 1, 2007, and Units 3 and 4 were retired on October 1, 2009.

Wisconsin Electric has determined that continued operation of PIPP will require a significant investment in air quality control equipment. After reviewing various alternatives, including closing down PIPP, Wisconsin Electric has entered into two agreements with Wolverine: (1) an Ownership Exchange and Participation Agreement; and (2) an Operating and Maintenance Agreement. The essence of the two agreements is as follows:

1. Wolverine agrees to pay the entire cost of the AQCS project necessary to ensure PIPP's continued compliance with state and federal environmental laws.
2. In return for Wolverine agreeing to pay the AQCS project cost, Wisconsin Electric will transfer to Wolverine an undivided ownership interest in PIPP proportional to Wolverine's investment in the AQCS project.
3. Wisconsin Electric will operate PIPP under an operating agreement that will allocate PIPP's output, operating costs, and future capital costs based on Wisconsin Electric's and Wolverine's respective ownership interests.

II. Rationale for the transaction.

As a coal-fired power plant, PIPP is subject to various federal environmental regulations, some of which will become more stringent over the next few years. In particular, the federal Mercury and Air Toxic Standards Rule for Power Plants (MATS) has a compliance deadline of April 16, 2015, subject to the permitting authorities' discretion to grant up to a one year extension. In addition, the 1-hour National Ambient Air Quality Standard ("NAAQS") for sulfur dioxide (SO₂) requires that PIPP reduce its SO₂ emissions. While the exact compliance date for the SO₂ NAAQS is not certain, EPA's initial implementation schedule would have required compliance with the NAAQS standard at PIPP in 2017. The compliance date, however, will now be extended while EPA undertakes rulemaking on SO₂ NAAQS implementation. Wisconsin Electric believes it is unlikely that EPA will grant waivers to provide sources with additional time to comply with the emission reductions required to meet the SO₂ NAAQS - particularly since the standard has been in place since 2010.

In addition, EPA revisions to the existing ozone standard are anticipated which will require reductions in NO_x emissions from PIPP.

Using EGEAS, Wisconsin Electric has analyzed several alternatives for complying with the more stringent environmental standards. That analysis shows that the transaction for which this Application seeks Commission approval has the lowest net present value revenue requirement. In other words, from the standpoint of Wisconsin Electric's retail electric customers, the proposed transaction is the least costly way to solve the problem. The alternatives investigated consist of:

Base Case
(Proposed
Transaction).

Install new emission controls at PIPP with capital costs paid by Wolverine in exchange for corresponding ownership interest in PIPP.

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|----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Alternative 1. | Install new emission controls at PIPP with capital costs paid by Wisconsin Electric.

NPV revenue requirement: \$280 million more than proposed transaction. |
| Alternative 2. | Retire PIPP and rely entirely on new transmission investment to maintain system reliability and meet Wisconsin Electric's power needs.

NPV revenue requirement: \$290 million more than proposed transaction. |
| Alternative 3. | Replace the PIPP units with new gas-fired combined cycle units.

NPV revenue requirement: \$610 million more than the proposed transaction. |
| Alternative 4. | Repower PIPP units with natural gas.

NPV revenue requirement: \$550 million more than proposed transaction. |

As the EGEAS analysis demonstrates, the proposed transaction for which Wisconsin Electric seeks Commission approval is \$280 million less costly in NPV revenue requirement than the next-best alternative.

Compliance with the more stringent environmental standards cannot be accomplished by simply retiring the PIPP units. MISO confirmed that retirement of the PIPP units is not a reasonable alternative in a letter to Wisconsin Electric dated January 19, 2012:

After being reviewed for the power system reliability impacts as provided for under Section 38.2.7 of the Midwest ISO's Open Access Transmission, Energy & Operating Reserves Tariff ("Tariff") the retirement of the units prior to installation of

transmission upgrades to the greater Marquette, MI area would result in violation of applicable reliability standards, creating unacceptable reliability issues.

(Emphasis added.) Thus, retiring the PIPP units without first significantly upgrading the transmission system in the Upper Peninsula and/or installing appropriate replacement generation resources would violate reliability standards. In addition to being completely irresponsible, such failure to comply with reliability standards would expose Wisconsin Electric to civil penalties of up to \$1 million per day.¹

As the letter from MISO suggests, simply retiring the PIPP units introduces unacceptable reliability issues in the Upper Peninsula. Planning, gaining approvals for, and constructing the necessary transmission upgrades will take from 8 to 11 years, resulting in an in-service date of 2021 to 2024, a period that extends far beyond the compliance deadline for MATS and jeopardizes timely compliance with implementation of the SO₂ NAAQS. In addition to this timing problem, the EGEAS analysis demonstrates that retiring the PIPP units and installing appropriate transmission upgrades would cost \$290 million more than the approach for which Wisconsin Electric seeks Commission approval.

III. Description of the proposed AQCS project.

A detailed description of the proposed AQCS project is included in the Appendix to this application. In summary, the AQCS project is currently projected to include the following components:

¹ As the designated Electric Reliability Organization under Section 215 of the Federal Power Act (FPA), the North American Electric Reliability Corporation (NERC) is charged with developing and enforcing reliability standards for the interconnected bulk power system in North America and has the authority to fine U.S. entities that violate its standards up to \$1 million per day per violation. 16 U.S.C. § 825o-1(b).

- For SO₂ control, installation of Spray Dryer Absorbers and Powered Activated Carbon on PIPP units 5, 6, and 7 and Dry Sorbent Injection on units 8 and 9.
- For NO_x control, individual unit boosted over-fired air systems on each of the five PIPP units.
- For particulate removal, bringing out of retirement units 1-4 fabric filters and booster fans and reconfiguring all fabric filters to serve units 5-9.
- Balance of plant equipment, including a lime storage and slurry preparation facility, a new ash collection system for the Toxecon fabric filter, and new redundant auxiliary transformers to feed the AQCS equipment.

The estimated cost of the AQCS project is \$130-140 million, all of which will be paid by Wolverine if the Commission approves the proposed transaction.

IV. Agreements governing the proposed transaction.

Effective November 23, 2012, Wisconsin Electric and Wolverine entered into two agreements that will govern the proposed transaction:

- (1) the Presque Isle Power Plant Ownership Exchange and Participation Agreement; and
- (2) the Presque Isle Power Plant Operating and Maintenance Agreement.

A. The Ownership Exchange and Participation Agreement.

The Ownership Exchange and Participation Agreement provides that, once certain conditions are satisfied, including receipt of all required regulatory approvals:

- Wolverine will pay one hundred percent (100%) of the costs of the AQCS project.
- Wolverine will transfer to Wisconsin Electric a percentage undivided interest in the AQCS project.
- Wisconsin Electric will transfer to Wolverine a percentage undivided ownership interest in PIPP.
- Upon the indicated transfers, Wisconsin Electric and Wolverine will own PIPP, including the AQCS which will have become an integrated part of PIPP, as tenants in common.
- Wisconsin Electric will act as agent for itself and for Wolverine in connection with implementing the AQCS project, the cost of which Wolverine will pay. Wisconsin Electric, as agent, will also be responsible for operating and maintaining PIPP during the period when the AQCS project is underway and once the AQCS has been installed.

The following example will illustrate how respective ownership interests will be determined:

Assume that the total actual cost of the AQCS project -- paid entirely by Wolverine -- is \$100 million. Also assume that the book value of PIPP -- not including the AQCS -- is \$200 million.

In that case, Wolverine's ownership interest in both PIPP and the AQCS would be:

$$\frac{\$100 \text{ million}}{\$200 \text{ million} + \$100 \text{ million}} = \frac{\$100 \text{ million}}{\$300 \text{ million}} = 33.3\%$$

Correspondingly, Wisconsin Electric's ownership interest would be 66.7%.

Additionally, the value of Wisconsin Electric's rate base -- and thus the return of and return on that rate base -- does not change as a result of the proposed transaction. In the example, before the transaction takes place Wisconsin Electric owns 100% of PIPP, an asset with a hypothetical book value of \$200 million. This 100% ownership interest consequently contributes \$200 million to rate base. After the transaction takes place and with the completion of the AQCS project, Wisconsin Electric owns 66.7% of PIPP (valued at \$200 million) and 66.7% of the AQCS (valued at \$100 million). This 66.7% ownership interest contributes \$200 million to rate base (66.7% of \$200 million + 66.7% of \$100 million). Thus, Wisconsin Electric's rate base does not change as a result of the transaction.

On the other hand, if, instead of partnering with Wolverine, Wisconsin Electric were itself to pay the cost of the AQCS project, its rate base in the hypothetical example would grow from \$200 million to \$300 million, with a corresponding increase in capital cost (return of and return on rate base) paid by Wisconsin Electric's customers.

B. The Operating and Maintenance Agreement.

Under the operating and maintenance agreement, Wisconsin Electric will act as agent for itself and Wolverine, as co-owners of PIPP, and will be responsible for operating and maintaining the facility. Wisconsin Electric and Wolverine will share O&M costs, including fuel costs, and future capital costs (if any) in proportion to their ownership interests. They will also

share, in proportion to their ownership interests, the output of the facility, including energy, ancillary services, by-products and environmental allowances or attributes.

Note that the PIPP O&M costs, including fuel costs, paid by Wisconsin Electric and its customers will be reduced compared to what they would otherwise be because Wisconsin Electric will no longer be responsible for 100% of those costs.

V. Commission approvals sought.

By this application, Wisconsin Electric seeks Commission approval of the proposed transaction under §196.80, Wis. Stat., which provides in relevant part:

"With the consent and approval of the commission but not otherwise a public utility may . . . sell, acquire, lease or rent any public utility plant or property constituting an operating unit or system."

While not expressly addressed by the statute, the transfer by Wisconsin Electric to Wolverine of a partial ownership interest in PIPP may reasonably be construed as a "sale" of public utility plant constituting an operating unit, thus requiring commission approval. Section 196.80 further provides

"If the commission finds that the proposed action is consistent with the public interest, it shall give its consent and approval in writing.

As explained above, the proposed action is very much consistent with the public interest. It addresses the need to ensure environmental compliance at PIPP in a way that minimizes the cost to Wisconsin Electric's customers.

As indicated above, Wisconsin Electric also seeks a certificate of authority for the AQCS project if, and only if, the Commission determines that a CA is required.

Dated this 8th day of February, 2013.

Respectfully submitted,

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